REPORT OF THE FRANCHISE LAW COMMITTEE ON CALIFORNIA CASE LAW RELATED TO FRANCHISING

By Don M. Drysdale[1]

Although calendar year 2004 (and the very end of 2003) did not produce any landmark decisions with respect to franchise law, there were several California cases that dealt with franchise-related issues.

Does a Franchise Exist?

In *Adees Corp. v. Avis-Rent-A-Car System, Inc.* [2], Avis terminated on 30 days notice and without cause a "relationship" with the operator of the car rental facility at the Long Beach, California airport. The terminated operator, who had been with Avis since 1999, sued Avis for wrongfully terminating its "franchise". But the court agreed with Avis that the terminated relationship was not a franchise, and granted Avis summary judgment.

Adees' written agreement with Avis provided that Adees would act as an "independent commissioned operator of the facility that Avis owned". Adees paid no initial fee, and the agreement specifically stated that Adees was neither a franchisee nor an employee of Avis. Avis purchased and supplied all the vehicles and bore the costs of operating those vehicles. Adees held money received from rentals and deposited it daily into an Avis bank account. Avis paid Adees a commission on time and mileage revenues from customer rentals, refueling revenues and prepaid gasoline charges, and deducted from the commissions a fleet surcharge per vehicle for each day the vehicle was assigned to the facility. Adees could return excess vehicles to Avis whenever the number of vehicles allocated to the facility exceeded its needs.

In 2002, Avis sent Adees a 30-day notice of termination. Adees sued, alleging violations of the California Franchise Relations Act[3] (the "CFRA"), and breach of the covenant of good faith and fair dealing. The parties filed a joint motion for summary judgment on the issue whether Adees was a franchisee entitled to protection under the CFRA. In determining if the CFRA applied, the court focused on whether Adees paid a franchise fee. The U.S. District Court for the Central District of California noted that the mere presence of a statement in the agreement that Adees was *not* a franchisee was not dispositive. Adees argued that the fleet surcharge and refueling charge were payments for the right to enter into business and, therefore, were franchise fees. Finding little California case law on point, the court examined common law precedents from other states on three factors: whether the payor received something of value for the payments; whether the payments were ordinary business expenses or unrecoverable investments; and whether the payor put its own money at risk. Based upon these factors, the court concluded that the fees that Adees paid were not franchise fees. The fleet surcharge was not a franchise fee because Adees received something of value in return - a fleet of cars that was necessary to run the business; the payment was an ordinary business expense; Adees could return cars; Adees did not put its own money at risk; and, it did

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2 *Adees Corp. v. Avis-Rent-A-Car System, Inc.,* Bus. Franchise Guide (CCH) ¶12,702 (C.D. Cal. November 20, 2003).

3 California Business and Professions Code §§20000 through 20043.

not actually pay anything, its commissions were reduced by the surcharge. The court also noted that Adees was not required to make payments for advertising and the surcharge was not a payment imposed for the right to do business. As for the refueling charge, there would be no sale of gas without the car rental, which required the use of Avis' cars. Because Avis provided the inventory that made the gas sale possible, its retention of a percentage of the gross revenue from the entire transaction did not convert the refueling charge into a fee for the right to do business. The court concluded that the agency agreement was not a franchise agreement because Adees did not pay a direct or indirect franchise fee and that Avis was free to terminate the contract pursuant to its terms.

Illegal or Unregistered Franchises

In *Pour Le Bebe, Inc.* v. *Guess? Inc.* [4] (certified for partial publication), Pour Le Bebe ("PLB") entered into a license agreement with Guess in 1992. Guess granted PLB the exclusive right to use the Guess marks and related design rights to manufacture and sell clothing and accessories for babies, boys, and girls. The agreement required arbitration in Los Angeles. In 1994, Guess and PLB entered into another license agreement for home furnishings, with a similar arbitration provision. In 1998, a dispute arose, and Guess demanded arbitration. The demand stated that PLB defaulted on its obligation to pay royalties and that Guess had terminated the licenses. In 1999, PLB counter-demanded, alleging that Guess wanted to take control of PLB's business by destroying PLB's financial viability and that the agreements were illegal franchises. PLB sought, among other remedies, disgorgement of all royalties, fees, and other payments made to Guess since 1984. The arbitration went forward and the panel awarded Guess $5,563,861 in damages, plus $901,968 in interest and $1,193,848 in fees and costs - for a total award of $7,659,677. The panel concluded that Guess had given notice and opportunity to cure, which expired on January 25, 1999, and, although the parties continued to negotiate a buyout for a time, PLB eventually lost the right to cure. The panel ruled that by allowing late royalty payments in the past, Guess did not waive its right to terminate.

The trial court confirmed the arbitration award and PLB appealed. It contended that the award was unenforceable because the contracts were unlawful as unregistered franchises and were, therefore, void *ab initio.* The court held that PLB' s claim of illegality lacked that "explicit legislative expression of public policy" that supported the decisions to vacate other awards. The court explained that the franchise laws are intended primarily to protect franchisees from being defrauded by or losing their investment by "shady" franchise operators, not to give a windfall to a disgruntled licensee after many years of profitable operation. That PLB did not claim that the license agreements were franchises or seek to rescind them until long after they were signed and the parties' relationship soured, also led the court to reject this claim and uphold the award.

The California Court of Appeals also left undisturbed an arbitrator's finding that the relationship between the parties was not an illegal franchise because it had not been registered. A major factor in this holding was the fact that defendant tried to use the argument that the relationship was an illegal franchise many years later as a defensive measure to the Guess' claims of breach.

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4 *Pour Le Bebe, Inc. v. Guess? Inc.,* Bus. Franchise Guide (CCH) ¶12,683; 2003 Cal App. LEXIS 1553 (Cal. App. October 15, 2003).

Grounds for Termination of Franchise Relationships

The case of *JRS Products, Inc. v. Matsushita Electric Corporation of America*[5], arose out of a termination that Matsushita admitted violated the California Franchise Relations Act. JRS became a dealer for Matsushita's Panasonic line of copiers in 1989 and fax machines in 1991. Panasonic had the right to terminate the agreement upon 90 days' notice without cause. JRS eventually became a fax machine dealer and began to market remanufactured Panasonic toner cartridges, selling them at a price lower than new cartridges. But JRS included, without Panasonic's consent, a 1996 Panasonic dealer authorization letter as part of the solicitation package it sent to potential customers. JRS claimed that it was not aware that Panasonic considered terminating its franchise for unauthorized use of that letter. Panasonic executives were concerned that sales of remanufactured toner cartridges were cutting into profits and adversely affecting business, so Panasonic decided to terminate JRS. Panasonic sent a memo to all fax dealers threatening termination if they solicited sales from customers in Panasonic's national account program. JRS believed that the customers in Panasonic's letter referred only to a specific account, which otherwise would have been a prospective national account for Panasonic. So, it continued its remanufacturing activities. Thereafter, JRS received a termination letter, which did not provide a reason for the termination, and efforts to persuade Panasonic to reinstate the dealership were unsuccessful.

JRS sued in Superior Court, asserting eight causes of action, including breach of contract and tortious interference with prospective economic advantage. The court granted Panasonic summary judgment on all counts except tortious interference with prospective economic advantage. The trial court later denied Panasonic's motion for non-suit on an interference claim, and the jury awarded JRS compensating damages of $720,620 and punitive damages of $2,500,000.

Panasonic appealed the judgment on the tort claim and JRS cross-appealed the dismissal of the contract claim. The CFRA prohibits a franchisor from terminating a franchise without good cause and requires the franchisor to give a franchisee notice to cure any breaches. On appeal, Panasonic did not assert that it had good cause or that it gave JRS adequate notice. In fact, it conceded the termination was wrongful under the CFRA and under the unfair competition law. Panasonic argued that the repurchase of inventory is the exclusive remedy for wrongful termination of a franchise pursuant to section 20035 of the CFRA, and that contract damages were not available for its violation of the statute. The California Court of Appeals, however, rejected the argument, noting that the CFRA "plainly" provides that a franchisee may seek any common law remedies for wrongful termination of a franchise.

Unfortunately for JRS, the appellate court also held that JRS had prevailed at trial "on the wrong theory." The court reasoned that the interference claim failed as a matter of law because Panasonic's alleged interference was not separate and distinct from the alleged breach of the dealer agreement. Concluding that "JRS' remedy for the wrongful termination was limited to contract damages," the court reversed the compensatory and punitive awards.

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5 *JRS Products, Inc. v. Matsushita Electric Corporation of America,* Bus. Franchise Guide (CCH) ¶ 12,726; 2004 Cal. App. LEXIS 95 (January 26, 2004).

Integration Clauses

In *It's Just Lunch International, LLC v. Polar Bear, Inc.*[6], the court refused to dismiss a franchisee's fraud claims despite the franchisor's reliance on the franchise agreement's integration/merger clause. Under California law, although parol evidence is inadmissible to prove promissory fraud, the franchisee alleged fraud in the inducement. Under well established California precedent, parol evidence is admissible to prove fraudulent inducement even though the contract contains an integration/merger clause reciting that all conditions and representations are contained solely in the parties' agreement.

Price Fixing

In *Dagher v. Saudi Refining Inc.*[7], the Ninth Circuit reversed a the grant of summary judgment by the U.S. District Court for the Central District of California for defendants Shell Oil Co. and Texaco, Inc. on claims that they conspired to fix prices. Shell and Texaco had created a national alliance of two joint ventures, Equilon and Motiva, to unify the refining and marketing of their gasoline brands in the eastern and western United States. As part of the overall arrangement, they agreed to end all competition between the two companies in refining and marketing, and, also, to price their previously competing branded gasoline at fixed price levels. Plaintiffs were a class of 23,000 dealers who sued Shell, Texaco and Saudi Refilling, alleging that the joint ventures involved a *per se* unlawful nationwide scheme to fix prices for their gasoline. In the alternative, they argued that the scheme should be condemned under a slightly more rigorous "quick look" standard. Notably, however, plaintiffs did not also argue in the alternative for a violation of the rule of reason, relying solely on the *per se* standard. Both sides filed motions for summary judgment.

The trial court granted Saudi Refining's motion, finding no evidence that any plaintiff purchased gasoline directly from Saudi Refining and that they therefore lacked antitrust standing. It also granted summary judgment for Shell and Texaco, holding that the rule of reason approach, rather than the *per se* rule or "quick look" analysis, governed claims under the Sherman Act involving otherwise legitimate joint ventures. Plaintiffs appealed.

The Ninth Circuit upheld the dismissal of Saudi Refining for lack of standing. The court disagreed, however, with the trial court's analysis of the price fixing issue. Citing *National Society of Professional Engineers v. U.S.*[8], the Ninth Circuit acknowledged that the U.S. Supreme Court did not read the Sherman Act to render any agreement regarding prices *per se* illegal. The court explained that a price fixing arrangement is generally evaluated under the rule of reason if "the restraint is sufficiently important to attaining the lawful objectives of the joint venture that the anticompetitive effects should be disregarded." However, where, as in this case, the defendants did not produce any persuasive evidence showing a pro-competitive justification for the price-fixing scheme, the *per se* standard applied.

Shell and Texaco made two arguments in defense of their pricing agreement. First, they asserted that any bona fide joint venture must be able to set prices for its products at whatever level it chooses. Second, they claimed that they set prices to avoid charges

6 *It's Just Lunch International, LLC v. Polar Bear, Inc.,* Bus. Franchise Guide (CCH) ¶12,819 (S.D. Cal. April 29, 2004).

7 *Dagher v. Saudi Refining, Inc.,* Bus. Franchise Guide (CCH) ¶12,838; 369 F.3d 1108 (9th Cir. June 1, 2004).

8 *National Society of Professional Engineers v. U.S.,* 435 U.S. 679 (1978).

of price discrimination under the Robinson-Patman Act[9]. The court rejected both arguments. As to the first defense, the court noted that Shell and Texaco's pricing arrangement was not ancillary to their joint venture - indeed, it found that they had agreed to unify their pricing even before reaching agreement as to the joint venture structure, and even though, in the court's view, the venture's objectives could have been achieved without such common pricing for the companies' different gasoline brands. As to the second defense, the court explained that because the evidence showed that Shell and Texaco went to great lengths to differentiate their gasoline brands, dealers could not allege the requisite harm to competition merely on the basis of a price differential for the two products, as required to prevail under the Robinson-Patman Act. The Ninth Circuit therefore reversed the district court's grant of summary judgment and remanded for further proceedings.

Dagher also makes clear that simply labeling a project a "joint venture" does not immunize the participants' conduct, particularly with respect to pricing, from antitrust scrutiny. Importantly, however, the court was careful to limit the scope of its holding.

Venue Selection

Two decisions demonstrate that venue selection clauses may not govern intrastate disputes. First, in *Alexander* v. *The Superior Court of Santa Clara County*[10], sales agents for a cellular service company ("Brix") had contracts with clauses limiting venue to Santa Clara County, California, the headquarters for Brix. The sales agents worked in Fresno County, California. After Brix sued the sales agents in Santa Clara County, in separate actions for breach of contract, the agents moved to change venue to Fresno County, arguing that the Santa Clara County court was not a proper court under the pertinent venue statute. Brix contended that venue was proper because the contracts had been entered and the obligations incurred in Santa Clara County. Additionally, Brix contended that the venue clauses in the contracts should be enforced. The trial court denied the sales agents' motions and they appealed.

The California appellate court observed that there is a difference between forum selection clauses and venue selection clauses. Forum selection clauses usually choose between courts of different states or nations while venue selection clauses choose between counties and are thus a matter of intrastate law. California's venue statute fixes the place of trial generally the county where the defendant resides. The court concluded that previous California Supreme Court decisions invalidating a venue selection clause was still good law, and required reversal of the district court's orders.

A second court applied traditional rules of contract construction to resolve a conflict between the choice of law provisions in a settlement agreement and release in the case of *Oh v. Coldwell Banker Best Realty*[11]. Mr. and Mrs. Oh purchased three Econo Lube franchises from Econo Lube's agent, Coldwell Banker Best Realty ("CBBR"). Shortly after the Ohs took possession of their first franchise, they learned that there was substantial construction nearby that decreased the franchise's business. A few months

9 15 USCA §13a *et seq.*

10 Alexander v. The Superior Court of Santa Clara County, Bus. Franchise Guide (CCH) ¶12,725 (Cal. November 20, 2003).

11 Oh v. Coldwell Banker Best Realty, Bus. Franchise Guide (CCH) ¶12,761; 2004 Cal. App. Unpub. LEXIS 1393; 2004 WL 247600 (February 11, 2004).

later, the Ohs entered a settlement and termination agreement with Econo Lube, whereby the Ohs returned the first franchise to Econo Lube in return for credits toward their two remaining franchises. Texas law governed the termination agreement, although it contained a mutual release from liability specifically governed by California law. The Ohs' other two franchises were also struggling. A few months later, the Ohs entered a second settlement and termination agreement with Econo Lube, terminating the second franchise and setting forth a payment plan. The second termination agreement also contained a release for claims arising out of the franchise agreements and stated that California law would govern any disputes. The Ohs sued CBBR and its sales agent for fraud and negligent misrepresentation. CBBR and its sales agent moved for summary judgment on the releases in the termination agreements. The trial court granted the motion and the Ohs appealed. The Ohs argued that Texas law should apply to the first termination agreement. The appellate court acknowledged the general provision in the contract involving Texas law, but ruled that the specific release provision controlled over the general provision, and therefore affirmed the decision.